No. 92-873

IN THE

Supreme Court of the United States

October Term, 1992

ALLSTATE INSURANCE COMPANY,
Petitioner,

vs.

CYNTHIA MALESKI, Acting Insurance Commissioner of the Commonwealth of Pennsylvania as Rehabilitator of The Mutual Fire, Marine & Inland Insurance Company, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF PENNSYLVANIA

SUPPLEMENTAL BRIEF OF ALLSTATE INSURANCE COMPANY

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PARTIES TO THIS PETITION

Petitioner

Allstate Insurance Company

Respondents

Cynthia Maleski, Acting Insurance Commissioner of the Commonwealth of Pennsylvania, as Rehabilitator of The Mutual Fire, Marine and Inland Insurance Co.

Committee of Policyholders

Colonial Penn Group, Inc.

AIG Risk Management

Pepsi-Cola Bottling Co. of Charlotte, Inc.

Fireman's Fund Insurance Co.

Evanston Insurance Co.

RLI Insurance Co.

Pennsylvania Insurance Guaranty Assn.

Member Companies of Republic Insurance Group

RULE 29.1 STATEMENT

Parent:

Sears, Roebuck and Co. (USA)

Non-wholly owned subsidiaries:

ABP Midwest, Inc. (USA)
Allscrips Pharmaceuticals, Inc. (USA)
Associated Gas Resources, Inc. (USA)
Burkhart—AS 1983 Limited Partnership (USA)
DM Management Company (USA)
Fallowfield Developers Limited Parnership (USA)
Quantitative Data Systems, L.P. (USA)
Sanguine/A Anaderko, Ltd. (USA)
Sangatuck, II Cellular Investment Corp. (USA)
Science Center Associates (USA)
Scripps Center Associates (USA)
Washington Business Park Associates (USA)

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SUPPLEMENTAL BRIEF OF ALLSTATE INSURANCE COMPANY

Petitioner, Allstate Insurance Company, filed with this Court a Petition for Writ of Certiorari to the Supreme Court of Pennsylvania on November 19, 1992 (Case No. 92-873). Eleven days later, the Supreme Court of California decided the case of *Prudential Reinsurance Company v. The Superior Court of Los Angeles County*, No. S014036, 1992 WL 347585 (Cal., November 30, 1992).[1] This Supplemental Brief is filed pursuant to Supreme Court Rule 15.7.

The *Prudential* case is germane to this Court's decision on whether to grant the Petition because it emphatically repudiated an insurance commissioner's efforts to substantially impair a reinsurer's contractual setoff rights. The court refused to follow public policy arguments and arguments founded in equity in determining whether the contractual right of setoff as guaranteed by state statute could be abrogated by a state court in an insurance company liquidation proceeding. In addition, the *Prudential* case recognized that a reinsurer can setoff amounts it owes a defunct insurance company even though the obligations are not fully liquidated until after the liquidation proceeding has been commenced.

[1] As of the date of printing of this Supplemental Brief, the *Prudential* case was not reported. Petitioner will file a Westlaw copy of the *Prudential* case to be lodged in this proceeding in lieu of having the case reprinted. All references to page numbers of the *Prudential* case will be to the Westlaw "star" pagination (*e.g.*, *1).

ARGUMENT

I. Rejection of the Insurance Commissioner's "Public Policy" and "Equitable Considerations" Assertions.

In its petition, Petitioner argues that under *Neblett v. Carpenter*, 305 U.S. 297 (1938), creditors of a defunct insurance company must receive under a rehabilitation plan at least what such creditors would have received upon liquidation in order for the plan to meet constitutional requirements. Petitioner asserts that its contractual right to offset mutual obligations, as sanctioned by Section 221.32 of the Pennsylvania Statutes, is impaired under the Respondent's rehabilitation plan. The Pennsylvania Supreme Court relied on *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, 459 U.S. 400 (1983), for the proposition that contract rights can be impaired by state law if the state is prompted by a significant and legitimate state interest. The *Prudential* case is significant because of its rejection of the public policy arguments and equitable arguments relied on by the Pennsylvania Supreme Court in finding that the impairment of Petitioner's contractual setoff rights for the purpose of providing preferential distributions to policyholders served a legitimate state interest.

The Supreme Court of Pennsylvania held that public policy and equitable principles permitted the abrogation of Petitioner's contractual setoff rights. In addressing the effect of the Rehabilitation Plan on Petitioner's contractual setoff rights, the Court stated, "we find no error or abuse of discretion with this portion of the Plan as it is legitimately designed to ameliorate a financial hazard for the good of all involved." Pet. App. at A17.

In addition, the Court stated that setoff rights can be impaired because they are "not mandatory" and are "permitted solely within the sound discretion of the Court." *Id.* at A18. Clearly, public policy considerations and general equitable arguments served as the Court's justification for abrogating Petitioner's contractual setoff rights in violation of the rule established by this Court in *Neblett v. Carpenter.*

In the *Prudential* case, the Supreme Court of California rejected the insurance commissioner's argument that these same public policy and equitable arguments were adequate grounds for ignoring the statutory setoff provision. The court limited its consideration to the construction of the California statute permitting setoff. The court rejected arguments against setoff which called for judicial favoritism of one group of claimants (*i.e.*, policyholders) over another (*i.e.*, cedents) on purported equitable or public policy grounds. 1992 WL 347585 at *13. To be consistent with the California Supreme Court in *Prudential,* the Pennsylvania Supreme Court should have ignored the Respondent's public policy and equitable arguments and ruled that the Petitioner's contractual setoff rights, as sanctioned by state statute, were unconstitutionally impaired by the plan.

II. Rejection of the "Lack of Mutuality" Assertions.

The *Prudential* case is significant also because it rejected the insurance commissioner's arguments regarding mutuality for purposes of determining whether obligations owed between two parties can be setoff against each other. *Prudential* supports Petitioner's argument that the rehabilitation plan *substantially* impairs its contractual setoff rights in violation of the U.S. Constitution. The commissioner in *Prudential* argued that the obligations were not mutual because the debts owed by the reinsurers to the defunct insurance company (namely, payments on insured losses) are post-liquidation debts while those owed to the reinsurers by the defunct insurance company (namely, past due premiums owed pre-liquidation), are pre-liquidation debts. The commissioner reasoned that the debts owed by the reinsurers are post-liquidation because they are not in fact due until the policyholders' loss claims are liquidated, an event which occurs post-liquidation. Under the commissioner's argument, pre-liquidation debts cannot be setoff against post-liquidation debts. However, in *Prudential* the California Supreme Court followed *O'Connor v. Insurance Company of North America*, 622 F. Supp. 611 (N.D. Ill. 1985), and held that because the reinsurance contracts existed prior to the insolvency proceeding, the debts became payable on the date of insolvency and thus were deemed to be pre-liquidation. *Prudential*, 1992 WL 347585 at *6-7. Because the obligations between the reinsurer and the defunct insurance company were both pre-liquidation, the California Supreme Court in *Prudential* held that those obligations could be setoff against each other.

The Pennsylvania Supreme Court confirmed the rehabilitator's plan which did not permit this kind of setoff. The plan set December 4, 1986 as the date for determining the amount of the setoff. The plan does not permit the setoff of claims which became liquidated after December 4, 1986 and were due and owing as of the purported effective date of the Plan, January 23, 1990. It seems clear that under the reasoning in *Prudential*, the plan confirmed below constitutes a substantial impairment of Petitioner's contractual setoff rights because it precludes Petitioner from setting off mutual claims as of the date of the Plan, thus providing Petitioner substantially less than what Petitioner would receive upon liquidation. The abrogation of these contractual rights is in violation of the Contracts Clause of the United States Constitution, U.S. Const., art. I, §10, cl. 1.

CONCLUSION

The decision of the California Supreme Court in the *Prudential* case provides an additional basis for granting the Writ of Certiorari.

Respectfully submitted,

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